In the cases we have just been considering this Court held taxing laws passed by states to be void within the Fourteenth Amendment. They are direct authority that similar laws passed by Congress would be in violation of the Fifth Amendment. Let us take the last case referred to, the case of Gast Realty & Investment Co. v. Schneider Granite Company, 240 U. S. 55. The objectionable feature of the law there considered which made it invalid was that property owners were taxed for street improvements by an arbitrary rule. The arbitrariness consisted in a freakish and irrational method of determining the geographical extent of the property to be taxed. In the present case the arbitrariness consists in a freakish and irrational method of determining the time at which the values are to be fixed as the base for taxation. *For, in effect, the Departmental construction of the excess profits law says in one case 1880 values shall be taken, in the case at bar 1904 values, in another 1912 values and in another 1916 values, and so on.*

If there is any difference between this case and the Gast case, 240 U. S., 55, the law in the present case is the less rational of the two. It produces far greater irregularities. In the Gast case, 240 U. S., 55, the unlucky taxpayer would not be called upon to pay more than four or five times as much as his fortunate neighbor. But in the case now being considered the 1912 value of the claimant's ore lands was fifty times their value in 1904. Yet. other taxpayers whose situations as to the *values*

of their properties and the amounts of their incomes are precisely the same as the claimant's are allowed to use the 1912 values while the claimant is limited to 1904 values.

The law now in question can not be defended as a rough and ready method of approximating values. The discrepancies are too great. In our own case cost is less than 2% of present values. Possibly Congress might have taken an arbitrary date—such as March 1, 1913—as the date upon which invested capital value of *all* corporations should be fixed. But it could not, as the Department seems to think Congress intended to do, fix 1904 as the date for one taxpayer, 1912 for another, and 1916 for another.

(4) The present law as construed by the Department is utterly arbitrary and therefore invalid because the tax depends largely upon the cost of the taxpayer's property so that two taxpayers who have the same income, and property of equal value, will pay wholly different taxes if the cost of the property is different.

If the State of Missouri at the same time it passed the law considered in the Gast case, 240 U. S., 55, had passed an excess profits tax law in terms identical with the one passed by Congress, and that Missouri law had come before the Court to be argued at the same time that the Gast case was argued, could this Court by any possibility have said that the Missouri excess profits tax law

afforded a reasonable basis of classification while the law in the Gast case did not?

Consider the arbitrariness in the present case: The method of computing the tax is complicated but the only thing the taxpayer is concerned with is the amount of the tax finally determined. The net income of this Company for the year 1917, was $12,836,448.58. On this income the Department assessed a tax of $6,220,294.45. This is 48½% of the Company's income for the year. Another company with identical assets and identical business, the only difference being that its ore lands were purchased in 1912 instead of 1902, on the same income would pay a tax of only $5,139,109.84, or 40 per centum of its income. If legislation should select specifically La Belle Company and require it to pay in taxes over $1,000,000 more than its neighbor, precisely alike in all respects, hardly any one would question that that action was the extreme of arbitrariness. Yet, under a complicated mechanism that is what is done under the present law.

In final analysis the question is reduced to this: Is the difference in the *cost* of property enough of a difference to save the tax from the condemnation of utter arbitrariness? For ultimately the tax is made to vary with the cost paid for property.

Although the tax collected is taken out of income, it is measured not by the amount of the income, but by the cost of the property of the corporation as distinguished from income. If the cost of the property of a corporation is high enough

it will pay no excess profits tax at all, although it may have been in receipt in the year 1917 of an enormous income. On the other hand an income small as compared with the other will be taxed heavily if the property of that corporation was bought many years ago when property was cheaper. Therefore the defenders of this legislation must assert that it is reasonable and not arbitrary to make the amount of the income tax depend upon the cost of the property of the corporation. As we have said, to make the amount of the income tax depend upon property at all makes it dubious whether it can be held to be an income tax. But passing that point, is it justifiable to make the amount of the excess profits tax depend not upon the amount of the income but upon the *cost of property?* If the amount of tax is to be varied in any degree by the property of the corporation, it should be varied by present investment value and income producing ability of the property *rather than by its cost.*

It cannot be said that the rate of tax is the same in all cases and that the only inequality is the amount of the deduction allowed; for the final amount of the tax is made to depend on the cost of property. It is just as arbitrary as a law would be which allowed taxpayers living in Missouri to deduct 15% from net income before any excess profits tax is payable while other taxpayers are allowed to deduct only 8%.

In Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 158 U. S. 601, this Court said that a tax on the income from property was in reality a

tax on the property itself. This is necessarily true, for taxes on property itself must be paid out of its income. Now could a law, passed by a state, be seriously defended if it provided that *a fixed percentage of cost* should be taken as a tax? Would not even those who are most reluctant to invade the discretion of the legislative branch of the Government be forced to admit that such a law was wanting in due process? But except by the most specious of arguments such a supposed law can not be distinguished from the present law.

The final question therefore is: Can a classification based upon cost be defended? How would the Court which decided the Gast case regard a state law which provided for the levy of a tax upon abutting property to pay for a street improvement, the tax based not upon benefits or present values but upon the *cost* of the property? That would surely have been just as obnoxious as the assessment which depended upon the distance to the next parallel street.

It is the established law that in determining the validity of a rate to be charged by a public utility it is entitled to a return upon the fair *value* of its property rather than cost. Willcox v. Consolidated Gas Co., 212 U. S. 19; People v. Jamaica Water Company, 196 N. Y. 39; Cumberland T. & T. Co. v. Louisville, 187 Fed. 637.

We are not unmindful of the extreme caution which this Court will and should exercise in considering a claim that Congress has exceeded its

powers in the enactment of a taxing law. In the first century of the Government apparently the taxing power of Congress was not much brought into question before the Court. In previous cases when this contention has been raised this Court has sustained an excise tax levied on corporations and not on individuals; has sustained an exemption of smaller incomes, and has sustained a progressive rate of tax, the rate increasing on the larger incomes. But in the case now before the Court we have none of these. The exemptions which have been sustained and the progressive tax which has been sustained have been sustained because of a real difference in the situation of the two taxpayers. In the present case we have a Departmental discrimination which is based upon nothing but the date at which the taxpayer acquired his property. We are not saying that the Act is unconstitutional, but that the Department's construction would render it so.

In final analysis the question is one of degree. At one end of the pole all are agreed that the Courts can not be called upon to correct all inequalities and injustices in taxes. At the other end we assume that there will be universal agreement that a wholly arbitrary seizure of property, although under the guise of taxation—such as a tax on all incomes arising west of the Rocky Mountains—will be invalid as confiscation and deprivation of property without due process under the Fifth Amendment. In between these two extremes it must be a question of more or less.

The Court should not dismiss the contentions here advanced by admitting the principle, saying that this case is not of a character coming within the principle, for the Court should seriously inquire as to the application of a principle which it has repeatedly affirmed. If the classification in this case is to be held to be a valid exercise of the power of classification, it must be seriously questioned whether the principle itself—the principle that wholly arbitrary and baseless classification will amount to a violation of the Fifth Amendment—has not been abandoned. How can that principle be regarded as still operative if the classification in this case is held not to contravene it? If any action by Congress is ever to be held arbitrary of what character must it be if this classification is supported? How can the Court say in any subsequent case that there is an ultimate margin not reached by the classification in this case beyond which Congress can not go? Plainly, if two corporations are precisely identical in all respects and the portion of the income to be taxed is arbitrarily fixed, although the rate is the same, it is exactly the same as though there were an arbitrary variation in the *rate* of tax.

But here there *is* also an arbitrary variation in the *rate* of tax, for it must be remembered that invested capital not only determines the deduction or the amount of the income which is free from the excess profits tax, but determines also the *rate* of tax which the *remainder* of the income is to bear.

Thus, a corporation pays 20 per cent of its net income in excess of the deduction and not in excess of *15 per cent of its invested capital,* it pays 25 per cent of its net income in excess of 15 per cent and not in excess of *20 per cent of its invested capital,* and so on at increasing rates up to 60 per cent of its net income in excess of *33 per cent of its invested capital.* With the same income a change in the amount of invested capital may make a much heavier tax.

In Knowlton v. Moore, 178 U. S. 41, the Department had construed the war revenue act of 1898 so as to make the rate of tax to be paid by a legatee depend upon the size of the whole estate. There was much in the Act to lead one to believe that that was what Congress intended. This Court, however, deeming that a construction by which the tax to be paid by a legatee would depend upon the amount of another man's property would make the statute subject to serious doubt as to its validity, ruled that the Department's construction was erroneous and that the law should be construed so as to make the tax depend upon the size of the legacy. It is maintained that the doubt raised in that case by the Department's interpretation of that law was not as great as is created in this case by the interpretation placed by the Department on the law here in question.

The fact that the interpretation put upon the statute by the Department would make it unconstitutional is a most persuasive argument against

the soundness of that interpretation. This leads properly to the conclusion that the arbitrary and baseless classification insisted upon by the Department is not the true construction of the Act.

CONCLUSION.

It is respectfully maintained that the judgment of the Court of Claims sustaining the demurrer and dismissing appellant's petition should be reversed and the case remanded with proper instructions.

Respectfully submitted,

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